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SUBJECT: SRI LANKA: CENTRAL BANK GOVERNOR DESCRIBES ECONOMY'S STRENGTH TO AMBASSADOR BLAKE

1. (SBU) Summary and comment: Central Bank Governor Nivard Cabraal told Ambassador Blake during their introductory meeting that Sri Lanka's economy was healthy and its business climate good. Cabraal was making a personal effort to tell multilateral development banks, credit rating agencies, and international bankers the positive facts about the economy, because reports that reached them often focused on the negative. He also assured the Ambassador that the Rajapaksa government was no less business-friendly than its predecessors. Cabraal is a more visible and activist central banker than most, but should take care to ensure that his boosterism does not harm his credibility. End summary and comment.

Selling Sri Lanka to Donors and Lenders

2. (SBU) Ambassador Blake began his introductory call on Central Bank Governor Nivard Cabraal September 25 by asking about the governor's recent meetings with IMF and World Bank officials in Singapore. Cabraal said his objective had been to make senior IMF officials more aware of the favorable economic climate in Sri Lanka. Cabraal reported that his audience had been "pleasantly surprised" to learn that Sri Lanka's growth was strong and that foreign direct investment, exports, and the balance of payments surplus were all up this year. He attributed their surprise to the tendency for bad news to be reported in the press while good news was ignored.

3. (SBU) Cabraal added that he and his team had met with credit rating agencies and bankers in Singapore and had made the case for Sri Lanka's credit rating to be upgraded from its current sub-investment grade. Cabraal had particularly disagreed with the rating agencies' Spring 2006 shift of their outlook on Sri Lanka from "positive" to "negative." The raters had been too hasty, Cabraal thought. There had been military skirmishes, but there were no riots and investors had not fled. In fact, Cabraal said, investors had ignored the rating swing and had continued investing.

Prospects for U.S. Exports and Investment

4. (SBU) The Ambassador told Cabraal that the United States and Sri Lanka had good economic relations, but that U.S. exports to Sri Lanka were too small, particularly when compared with SL's exports to the U.S. With so much business interest in India now, there were prospects to increase U.S. trade and investment in Sri Lanka as well. For example, the Indo-Lanka Free Trade Agreement offered ways

to export to India's still high-tariff market by sourcing products from Sri Lanka. Also, Sri Lanka could capitalize on its workers' strong English and accounting skills to attract some back office operations and information technology investment that might otherwise go to India.

15. (SBU) Ambassador Blake cautioned, though, that instances of apparent failure to honor contracts - as in the government's refusal to pay American energy company AES for some power it had produced - had caused U.S. companies some concern about the investment climate in Sri Lanka. Similarly, newly imposed taxes had given the impression that the Rajapaksa government was less business-friendly than its predecessor. Cabraal dismissed this perception, saying that he frequently heard businesses claim it was hard to do business in Sri Lanka and then soon after report publicly that profits were up. On taxes, there had been policy "shifts," he said, but "nothing that should make businesses uncomfortable or hit their bottom line." In fact, Cabraal noted, he and a few others with economic portfolios in the Rajapaksa government had formerly been members of the opposition United National Party and were known for their pro-business approach.

16. (SBU) Cabraal nevertheless agreed that it was important to "get thorny issues out of the way so that we can move on with the rest." He explained that the government had set up an Investment Facilitation Committee, chaired by the President, which was charged with "unlocking problems." "Take AES there," Cabraal advised, saying it would be a sympathetic forum.

Oil Exploration Prospects

17. (SBU) The Ambassador raised the prospect of oil exploration in Sri Lankan waters, saying he hoped U.S. companies would be

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interested and that the Embassy had arranged for the U.S. Trade and Development Agency to provide technical assistance. Cabraal replied that the Central Bank had convened a core group to ensure that oil exploration would be handled correctly and that Sri Lankans would gain expertise in the process.

Financial Intelligence Unit

18. (SBU) Governor Cabraal concluded the meeting by stating that strengthening Sri Lanka's new Financial Intelligence Unit was another priority. The FIU was studying the transactions associated with the recent FBI arrests of LTTE operatives in the United States. The Ambassador replied that the State Department was convening a Contact Group meeting to explore how to help Sri Lanka stop money and arms from flowing to the LTTE. The Ambassador appreciated the input the FIU had provided in a briefing at the Ministry of Foreign Affairs the previous week.

Comment

19. (SBU) Central Bank Governor Cabraal seems intent on making the best possible case for the Sri Lankan economy. He is right that someone should be doing this, but it is risky for that person to be the Central Bank Governor. While the economy has performed very well this year, recent inflation and interest rate statistics (septel) suggest that the Central Bank has not been tough enough on inflation. Moreover, the current 8% growth rate of the Sri Lankan economy should not hide the fact that the GOSL must do much more to create a favorable business climate for new U.S. investors.

BLAKE